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Dominion Virginia Power

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Mr. David R. Eichenlaub, Assistant Director
Division of Economics and Finance
Virginia State Corporation Commission
P.O. Box 1197
Richmond, VA 23218

Dear Mr. Eichenlaub:

Dominion Virginia Power ("Dominion" or "the Company") is pleased to submit our annual comments on the status of electric industry restructuring and competition in the Commonwealth. We hope these comments will be useful to the Staff and to the Commission as you develop your annual report.

As we have stated in past years, Dominion believes the Virginia restructuring program has produced significant benefits for consumers and promoted efficiency in the electric industry. The Commonwealth's restructuring effort has shown it can successfully adapt to changing circumstances. This flexibility, based on close regulatory and legislative oversight, has helped Virginia avoid the problems that have occurred in some other states undertaking restructuring. Virginia's program has laid a strong foundation for retail competition. Interest in customer choice remains high among competitive suppliers and aggregators, and the restructuring movement took a major step forward this spring when the Commission licensed the City of Fairfax as Virginia's first municipal aggregator. A higher level of retail competition should not be expected to develop until market conditions improve (i.e., wholesale market prices fall below capped rates). This would provide competitive suppliers with increased opportunity to make favorable offers. This situation could occur at some time during the period from July 1, 2007 through December 31, 2010. During this period Dominion's capped rates will be adjusted annually to reflect actual fuel costs.

Restructuring Already Producing Significant Consumer Benefits

While the restructuring process has not been perfect in Virginia, it has produced significant benefits for the Commonwealth's consumers. This is due in large measure to the close regulatory and legislative oversight built into the process. This oversight mechanism, apparently lacking in some other restructured states, has allowed Virginia to make necessary midcourse corrections to protect customers and keep the process on track.

The freeze imposed on Dominion's fuel factor by the 2004 General Assembly has produced hundreds of millions of dollars in savings for the Company's customers. The freeze, extending through mid-2007, was implemented just as fuel prices began surging toward record levels. The Company recently estimated the freeze will produce savings of about $260 for the typical residential customer using 1,000 kWh per month during the two year period of 2005-2006.

The General Assembly in April took additional steps to ensure the accuracy of the reset of Dominion's fuel factor beginning in 2007 and protect customers from a dramatic price increase. The legislature approved Gov. Tim Kaine's amendment requiring that Dominion's fuel factor be adjusted annually from July 1, 2007 through July 1, 2010. The amendment eliminated the need for a long-term, 42-month projection of fuel expenses through the end of 2010. This would have presented the Commission with an extremely difficult, if not impossible, job. The amendment ensures that Dominion customers will pay no more for fuel than Dominion's actual costs and provides annual opportunities for correction. The amendment also allows the Commission to defer up to 40 percent of Dominion's 2007 fuel factor adjustment to subsequent years, blunting its impact on consumers and offering further price stability.

As we have noted in past comments, the capped rate provisions of the Virginia Electric Utility Restructuring Act have also produced substantial savings for customers. The 2004 Dominion-commissioned study by Chmura Economics & Analytics projected that capped base rates will save residential consumers served by the Company as much as $1.8 billion through 2010. Residential customers will see annual savings of up to $74 during the Restructuring Act's transition period due to capped rates, according to the study.

Restructuring savings are not confined to Virginia. An October 2005 report by Cambridge Energy Research Associates found restructuring, through 2003, had produced $34 billion in consumer savings nationwide. Another consultant, Global Energy Decisions, reported last year that customers enjoyed $15.1 billion in benefits through increased wholesale competition from 1999 through 2003. Both the Public Utility Commission of Texas and the New York Public Service Commission have found restructuring has generated significant savings for consumers in their states. In New York, the PSC estimated inflation-adjusted power prices for utilities' residential customers dropped an average of 16 percent between 1996 and 2004.

Rates Increasing in Non-Restructured States

Controversy over increases in states such as Maryland and Delaware with expiring rate caps has tended to obscure steady, and in some cases dramatic, rate increases in many non-restructured states. For example, Wisconsin Public Service rates for customers in the eastern part of the state have risen approximately 60 percent since 2001. If the company's latest petition is approved, the rate of increase would rise to approximately 81 percent. Florida Power and Light's monthly residential bill for 1,000 kWh has risen from $69.73 in 2000 to $108.61 this year, an increase of approximately 56 percent, largely resulting from increasing fuel expenses. Residential customers of Public

Service Company of Oklahoma, an AEP affiliate, experienced a 32 percent increase in December 2005 due to higher fuel prices.

As these examples indicate, escalating fuel costs have been the primary reason for the higher electric rates many consumers have experienced in recent years in states maintaining traditional cost-of-service regulation, as well as in restructured states. In addition, higher costs for equipment, materials (such as steel, copper and aluminum), labor and other factors in the production and delivery of electricity are exerting significant upward pressure on base electric rates.

Virginia Restructuring: Default Service

Virginia consumers can take comfort in the Commonwealth's careful steps to prepare for the expiration of capped rates and the beginning of market-based default service on January 1, 2011. As the Staff noted in their April 28 default service report, the Commission on Electric Utility Restructuring will soon begin a two-year review of the provision of default electric supply service after the capped rates expire. The study will allow Virginia to evaluate the experiences of other states and develop workable plans for the future. The CEUR review will also furnish this Commission with much of the information it will need to implement post-rate-cap default service.

Virginia Restructuring: Retail Competition

Interest by competitive power suppliers (CSPs) and aggregators in Virginia's restructuring program remains strong. As of May 4, six competitive suppliers and six commercial aggregators were licensed by the SCC. Of these, all except one aggregator were registered with Dominion. Market conditions, however, have made it virtually impossible for CSPs and aggregators to make customer offers more favorable than capped rate service. Wholesale market prices for electricity have risen sharply in recent years, in large part due to the rapid increase in fuel prices. The freeze imposed on Dominion's fuel factor by action of the 2004 General Assembly has protected consumers from rising fuel costs. However, this has made it even harder for CSPs to make attractive offers. We expect retail competition to begin developing in the Commonwealth as market conditions improve and the Dominon fuel factor is adjusted to recover increased fuel costs later in the decade.

We also continue to believe that aggregation provides the most effective means for bringing the benefits of retail competition to smaller customers, including residential customers and small businesses. One of the best ways to form customer buying groups is through municipal aggregation, with the city or county government acting as the buying agent for customers within the locality's boundaries. Municipal aggregation allows the locality's residents to achieve the critical mass needed to attract competitive providers. This method of procurement has had some notable successes elsewhere, including northeastern Ohio and the Cape Cod area of Massachusetts.

Municipal aggregation took a significant step forward this spring with the SCC's April 18 issuance of an aggregation license for the City of Fairfax. The license allows the city government to provide competitive aggregation service to residential, commercial and industrial customers within the city limits. Fairfax became the first locality in the state to apply for an aggregation license on February 21. This application followed Fairfax City Council's October 11, 2005 vote to create a municipal aggregation program with opt-out participation. (Customers will automatically be included in the aggregation unless they notify the city that they do not wish to participate.) With its license, Fairfax is now ready to enter the electricity market when conditions improve.

Dominion will continue to support Fairfax's efforts to conduct a successful aggregation program. Additionally, we will continue to assist other municipalities as they explore aggregation programs.

Retail Competition: Trends Elsewhere

Low shopping rates among smaller customers, coupled with continued rate caps and freezes, have tended to obscure the fact that fairly vigorous retail competition is developing in some states. This is especially true among larger users, such as industries and large commercial establishments. Data from several states emphasize this fact.

The New York Public Service Commission recently reported that competitive suppliers served 72 percent of the large commercial and industrial-class load in February; almost 55 percent of the accounts in the rate class were buying from competitive providers. Competition was also strong among small and medium-sized commercial customers, according to the Public Service Commission. Competitive providers furnished more than 44 percent of the rate class's load; almost 19 percent of the accounts within the rate class were shopping.

In Massachusetts, the Department of Telecommunications and Energy reported that competitive marketers in February were serving more than 56 percent of the state's large commercial and industrial users and 17 percent of its medium-sized commercial and industrial customers.

The attention centered on the pending standard offer service increases for residential customers in Maryland has also largely hidden the growth of electric competition in the state. Earlier this month the Maryland Public Service Commission said competitive providers served more than 80 percent of the large commercial and industrial accounts during March. Marketers also provided electricity to more than 15 percent of medium-sized commercial and industrial accounts. And in Maine, Public Utilities Commission shopping statistics indicate marketers served 38 percent of the state's total demand for electricity as of April 1. The Public Utilities Commission reported that competitive providers were serving 91 percent of the large industrial load in Maine Public Service's territory and 87 percent of the large industrial load in Central Maine Power's territory.

Consumer interest in retail competition also remains strong. A recent survey of registered voters in Connecticut found 87 percent want the ability to shop for power. Sixty-eight percent said competition was the best way to lower prices for energy, according to the survey sponsored by the Retail Electric Supply Association.

Virginia's Restructuring Effort: A Sound Plan for the Future

Virginia's restructuring effort has produced real savings for consumers and introduced greater efficiency in the electric utility industry. The initiative has shifted the risk for billions of dollars in new costs and investments from utility customers to the companies themselves and their shareholders. The Commonwealth's program has greatly benefited from the ongoing regulatory and legislative oversight prescribed by the Restructuring Act. Virginia's ability to monitor and correct its restructuring program sets it apart from the initiatives underway in several other restructured states. The oversight has allowed Virginia to deal with changing circumstances and make the midcourse corrections needed to keep the restructuring program on track. The examination of the post-rate-cap situation by the Commission on Electric Utility Restructuring is another example of this close oversight. The study should greatly assist all parties in developing the terms for the default service that will be offered after the capped rates expire.

Although market forces have worked against retail competition in Virginia in recent years, the Commonwealth's restructuring program has laid a solid foundation for customer choice. Interest by suppliers and aggregators remains high. The SCC's recent approval of a municipal aggregation license for the city of Fairfax marks a first step toward cities and counties acting as buying agents for their citizens. Additionally, significant numbers of customers are shopping for power in other restructured states, including Maryland, following the expiration of rate caps. Electric customers in Virginia are well positioned to realize continued benefits from capped rates during the rest of the transition period and to take advantage of the competitive market for electricity after the capped rates expire.

If we can be of further assistance as you develop your annual report, please let us know.

Sincerely,

E. Paul Hilton

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